Why the Popularity of BNPL?

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Commentary

I've become a fan of TubiTV. It's obvious why it is growing in popularity as a streaming service. There is no login and everything is instantly available. The movies and shows stream one after another so that you can have it on for hours, same as television in the old days.

And it costs nothing at all. It pays for itself with advertising, and the ads are oddly welcome because they are not the usual ones you see on network television.

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Many great old movies are there and plenty of shows too. Tired of woke? This is a service for you. Most movies before 2000 are actually reliably free of that nonsense. I always check this site before paying for content on other venues. It also allows me to observe what kinds of things are being advertised to those who are either unwilling to pay for streaming or lack the financial means. That alone is instructive.

A major advertiser for this service are the financial apps classified as BNPL, or “buy now, pay later” services. There are so many of them now that it is hard to keep up. The ads feature someone at the store with a large tab. The person notes that there is not enough money in the bank account to cover the costs. The idea is that you download an app, link it to your bank account, and then get an instant cash advance.

Maybe such services would be popular anytime but I suspect more so now that real income has fallen in these inflationary times. There are signs of hope on the horizon that the economy will improve in the future. Wall Street certainly thinks so and retail spending seems to be recovering but these ads tell a different story. They reveal just how much suffering there is out there right now, how many people truly do not have enough in the bank to pay basic costs.

On the one hand, this is very sad. On the other hand, these services are valuable and somewhat brilliant.

I’m not joining the chorus of commentators who are calling for them to be regulated or abolished. They exploit no one. They serve plenty of people. To be sure, they do cost money. What is the interest they charge? That’s a complicated question because mostly they are fee-based, like an ATM. The fees can be quite high in accord with the going rate, so anywhere from 7 to 20 percent.

One way or another, these companies are going to be paid back and then some. There is no such thing as a free lunch or free groceries. The

bill is going to be paid by someone.

Thinking of how these services work helps us understand something about the loan contract of medieval origins. They represent an exchange of people with capital in the form of money and people without capital in the form of money who need to consume something. When the first loan contract came along and families like the Medicis got rich, there was something of a moral panic in Europe. How can people make so much money merely by moving money around? It seems strange.

Every religious tradition has something different to say. The Christians (both Protestants and Catholics) mostly condemned the charging of interest as “usury” while Islam carved out a number of exceptions. The Second Lateran Council (1139) and Third Lateran Council (1179) both denied Christian burials for usurers. Indeed the Catholic church did not fully liberalize on the topic until the 19th Century.

Judaism did not condemn interest, reasoning that it was a perfectly justifiable exchange between people with excess and those without. It is for this reason that Jews developed the reputation as the money lenders: other religions could not come up with morally sophisticated justifications for the practice. Islam still retains its strictness though with exceptions.

What is the basis of the charging of interest? It is relatively simple: goods obtained now are more expensive than the same goods purchased later. It is called “time preference” in the economics literature, but you see it every day in regular pricing habits. It’s conventional that a flight purchased for two weeks from now is going to be cheaper than a flight leaving tomorrow.

It always pays to plan ahead. This is why people who forgo consumption today in favor of saving earn interest while people who live on revolving credit cards are paying more than 20 percent for the privilege. They are simply involved in an exchange: high time preference trading with low time preferences. Interest also covers

other factors such as the risk of not being paid back or the risk, in the case of business loans, that the enterprise will not be profitable.

Regardless, the free market has proven to be brilliantly adept at managing the exchange between the present and the future and pricing it in a rational way. You want those groceries now but don't have the money to buy them? You can get a cash advance—at a price that you agree to pay. There is nothing sketchy about this: it is a deal struck by parties based on voluntary decision-making.

The interest rate itself merely reflects the pricing of time relative to available resources. Like any other price, it can fluctuate based on underlying realities. When society is full of savers, more resources become available for lending and the interest rate is going to be pushed down. When society is full of high time preferences with more borrowers than savers, the interest rate is going to rise.

There is no role in any of this for the Federal Reserve to intervene to drive interest rates up or down. The belief that the Fed can and should do this is based on nothing but mythology. If the Fed acts to drive down rates lower than what the market would be, it is creating a distortion, what F.A. Hayek cleverly called "forced savings" because it signals the existence of resources that are not really there. That leads to a distortion in product structures such as we saw for the decades after 2000 and especially after 2008.

Such distortions achieve nothing for overall economic growth. They only end up fueling the boom/bust cycle. This is just another application of the general principle that government has no resources of its own that it does not take from the people. An artificially low rate of interest ends up creating new money and credit that funds unsustainable investments that result in inflation, as our present experience proves.

Thus do these BNPL programs end up creating loan markets of a different form. They are especially valuable among a class of borrowers who cannot gain access to credit cards. These days, getting a credit card is no easy task for some people, which is why debit cards

have become more common than ever. Still people need credit from time to time, and the markets have been brilliant in figuring out ways to make this possible.

I'm generally favorable to many of the Trump administration's proposed economic policies but this idea of capping interest rates on credit cards is not a good one. It will result in higher user fees elsewhere or end up denying credit to people who otherwise would have it, thus giving the BNPL industry a boost.

One thing it simply will not do is lower borrowing costs. Interest rate caps are no different from any other price control: they end up creating market distortions with unsustainable surpluses and shortages.

What credit markets need is to be left alone. This goes for the Fed's interventions, attempts to regulate credit card rates, or proposed regulations of the BNPL industry. They are operating just fine on their own. Hey, it's not my cup of tea but it's good they are there for people who need them. It so happens that people like me who are too cheap to buy movies without ads also happen to be the same demographic cohort to come up short for grocery money from time to time. It makes perfect sense.

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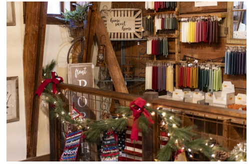

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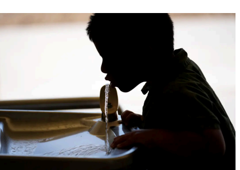

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